

# IRS Earned Income Tax Credit (EITC) Initiative:

## *Status Report to Congress\**

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In June 2003, the Internal Revenue Service (IRS) announced a five-point initiative to improve service, fairness, and compliance in the administration of the Earned Income Tax Credit (EITC). The IRS is conducting three programs to address the goals set forth in this initiative. These programs are the EITC Qualifying Child Residency Certification Study, the EITC Filing Status Study, and the EITC Automated Underreporter (AUR) Study.<sup>1</sup>

This document fulfills the Congressional mandate (Public Law 108-199, Section 206) for a preliminary report on the Qualifying Child Study (see Appendix A for details). It presents an overview of the EITC, as well as a brief history of recent EITC compliance efforts, especially the Tax Year 1999 EITC compliance study. This report also presents the design, status, and preliminary findings for the Qualifying Child Study, as well as the other two EITC studies. The three EITC studies will be completed in 2005, and a final report, containing results and recommendations, will be prepared for Congress at that time.<sup>2</sup>

### **The Earned Income Tax Credit (EITC)**

The EITC, enacted in 1975, provides a refundable tax credit for low-income working families. It was originally intended to offset the burden of Social Security taxes and provide a work incentive. The credit has been modified several times during the years since its introduction and now provides a substantial benefit to millions of American families. Eligibility for the EITC is based on three types of income: earned income, adjusted gross income, and investment income. The amount of the credit depends on earned income and adjusted gross income, as well as the presence and number of qualifying children and filing status. The credit amount is equal to a specified percentage of the taxpayer's income, up to a ceiling that varies by filing status and the number of qualifying children. Taxpayers with investment income greater than a specified amount are not eligible for the EITC.

A qualifying child must meet residency, relationship, and age tests. In particular, the children must reside with the claimant for more than half of the tax year. Married taxpayers filing separately do not qualify for EITC.

The EITC program has grown significantly since its inception in 1975. In its first year, 6.2 million taxpayers claimed \$1.25 billion in earned income

tax credits, or about \$4.0 billion in 2002 dollars. At that time, the maximum credit was \$400, or approximately \$1,300 in 2002 dollars, and the income level at which the credit phased out completely was \$8,000, or about \$26,100 in 2002 dollars.

Between 1975 and 2002, Congress significantly expanded the credit. Since 1991, the amount of the credit has varied with the number of qualifying children (up to two). Since 1994, a small credit has been available for taxpayers without any qualifying children. And, beginning in 2002, Congress provided marriage penalty relief by extending the credit's phaseout range for married couples.

In Tax Year 2002, the most recent year for which data are available, more than \$36 billion in credits were claimed; the maximum credit and income level at which the credit phased out completely had grown to \$4,140 (for taxpayers with two or more children) and \$34,178 (for married filing jointly taxpayers with two or more children), respectively. In Tax Year 2002, two thirds of all EITC claimants relied on paid preparers, and about the same percentage filed electronically.

For Tax Year 2003, the focus year for the current Qualifying Child Study, taxpayers who are married filing jointly with two qualifying children are eligible for the maximum credit at income levels between \$10,510 and \$14,730. The phaseout begins at \$13,730 for single and head of household taxpayers with two qualifying children. The credit completely phases out at \$34,692 for married taxpayers filing jointly and \$33,692 for single and head of household taxpayers. See Table 1 for the EITC parameters applicable to Tax Year 2003.

**Table 1. EITC Parameters for Tax Year 2003, by Filing Status and Number of Qualifying Children**

EITC Parameters	Filing Status					
	Single/Head of Household/ Qualifying Widow(er)			Married Filing Jointly		
	No Qualifying Children	One Qualifying Child	Two Qualifying Children	No Qualifying Children	One Qualifying Child	Two Qualifying Children
Credit percentage	7.65%	34.00%	40.00%	7.65%	34.00%	40.00%
Phaseout percentage	7.65%	15.98%	21.06%	7.65%	15.98%	21.06%
Maximum credit	\$382	\$2,547	\$4,204	\$382	\$2,547	\$4,204
Income at which begin maximum credit	\$4,990	\$7,490	\$10,510	\$4,990	\$7,490	\$10,510
Income at which begin phaseout	\$6,240	\$13,730	\$13,730	\$7,240	\$14,730	\$14,730
Income at which credit is completely phased out	\$11,230	\$29,666	\$33,692	\$12,230	\$30,666	\$34,692

## The Tax Year 1999 EITC Compliance Study

IRS compliance studies have consistently shown high overclaim rates for the EITC. The most recent IRS study of EITC compliance, the Tax Year 1999 EITC compliance study, estimated that between \$8.5 billion and \$9.9 billion of

the claims filed for Tax Year 1999 should not have been paid. The 1999 study estimates identified three major sources of errors.<sup>3</sup> These included qualifying child errors, filing status errors, and income reporting errors.

Qualifying child errors account for the largest share of overclaims. To claim a qualifying child, a taxpayer must satisfy relationship, age, and residency tests. However, the estimates from the 1999 compliance study indicated that the chief compliance issue associated with qualifying children involves the residency test.<sup>4</sup> In fact, the study estimates showed that about 80 percent of the EITC overclaimed on returns with qualifying child errors was associated with returns for which the child (or children) did not meet the qualifying child residency requirement or did not meet the residency and relationship requirements.

## **IRS Five-Point Initiative**

In the summer of 2003, IRS Commissioner Mark Everson announced a five-point initiative to improve service, fairness, and compliance with EITC rules. The IRS intends to:

- ☐ Reduce the backlog of pending EITC examinations to ensure that eligible taxpayers being examined receive their refunds timely;
- ☐ Minimize burden and enhance the quality of communications with taxpayers by improving the existing audit process;
- ☐ Encourage eligible taxpayers to claim EITC by increasing outreach efforts and making EITC requirements easier to understand;
- ☐ Ensure fairness by refocusing compliance efforts on taxpayers who claimed the credit but were ineligible because their incomes were too high; and
- ☐ Test a certification program to substantiate qualifying child residency eligibility for claimants whose returns are associated with a high likelihood of error. The certification program would take place during the filing season.

The three studies described in this report address the last two points of the Commissioner's five-point plan. The objective of these studies is to determine the effect of these programs on the EITC overclaim rate, the participation rate among eligible taxpayers, and the associated burden, both on the taxpayer and the IRS. As part of the burden analysis, the IRS will evaluate the costs and benefits associated with each of the studies in order to develop an estimate of the potential return on investment if the studies lead to implementation of the processes being evaluated. This will enable the IRS to determine

if certification (or the other processes being studied) is a cost-effective way to reduce erroneous EITC payments while maintaining historically high participation rates. The remainder of this report discusses each study, beginning with, and focusing on, the Qualifying Child Study.

## **EITC Qualifying Child Residency Certification Study**

In this study, the IRS seeks to determine the impact of residency certification on taxpayer participation in the EITC, on the number of children claimed by those taxpayers who continue to participate, and on the level of erroneous payments. The IRS also seeks to test the various components of the certification study. The results of this test will be used in the design of any future certification program. The current Qualifying Child Study was designed to include:

- ☐ A random sample of EITC claimants (the “test group”) for which IRS could not establish qualifying child residency eligibility through available data, and who, therefore, would be required to go through the certification process for Tax Year 2003;
- ☐ A control group of taxpayers with characteristics similar to the test group; and
- ☐ Extensive data collection, including a telephone/mail survey administered to a random subsample of taxpayers in both the test and control groups.

IRS will analyze the study data to determine the impact of certification on taxpayer filing behavior and will use the survey data to understand claimants’ experiences with the certification process and the effects on their filing choices. The survey will be administered by a contractor. In April 2004, IRS awarded a contract to design and administer the survey to Westat Corporation. Westat will administer the survey in the summer of 2004.

### ***EITC Qualifying Child Residency Certification Study Sample Development***

In developing a sample for the Qualifying Child Study, IRS took advantage of multiple data sets, including data from numerous internal and external databases that could be used to ascertain whether qualifying child residency requirements are met by EITC taxpayers. For the Qualifying Child Study,<sup>5</sup> IRS selected a random sample of 25,000 taxpayers who claimed the EITC with at least one qualifying child in Tax Year 2002 but for whom IRS could not estab-

lish, based on available data, that the residency requirements were met for one or more of those qualifying children.

IRS employed a two-stage sample design for the study. The sample frame for the first stage of the design was the population of taxpayers who filed Tax Year 2002 returns in the first 5 months of 2003 and claimed the EITC with at least one qualifying child. From this population of approximately 16 million taxpayers, IRS drew a 10-percent random sample. To these 1.6 million returns, IRS applied a computer algorithm that utilizes information from various data sources and identifies EITC claimants who were likely to have filed a claim that met the eligibility residency requirements for qualifying children. IRS excluded these taxpayers from consideration for residency certification. In addition, exclusions were also applied to ensure that IRS did not contact a taxpayer twice about the same return (e.g., for regular audit processing). The IRS computer algorithm utilized data from the following databases:

**Federal Case Registry**—A Department of Health and Human Services (HHS) database that identifies presumed custodial relationships based on child support cases;

**KidLink**—A Social Security Administration (SSA) database that identifies relationships between birth parents and children born since 1998;

**DM-1**—A database of Taxpayer Identification Numbers (either Social Security numbers or Individual Taxpayer Identification Numbers) and their associated name histories; and

**Numident**—SSA data that provide birth certificate information, including parent names.

The subset of claimants whose qualifying children could not be substantiated through the computer algorithm comprised the sample frame for the second stage of the design. Altogether, 73 percent of the EITC claimants in the 10-percent sample were excluded from the study based on data available from the above sources, leaving a pool of approximately 400,000 claimants in the second stage sample frame.

A systematic sampling process was used to draw two separate random samples of 25,000 taxpayers. The first sample of 25,000 serves as the study sample, and the second sample serves as a control sample. IRS also selected two 1,000-taxpayer subsamples from the 25,000-taxpayer test sample. The first subsample will be used to test a variant of the residency certification

documentation (see the next section for a discussion of the certification forms and schedules). In response to concerns that the English-only documents might weaken participation among the Spanish-speaking population, IRS sent forms and schedules in both English and Spanish to the secondary subsample. The sample size was driven by a desire to evaluate the operational and administrative issues that certification will involve for both IRS and the taxpayer.<sup>6</sup>

Mathematica Policy Research Inc., the U.S. Government Accountability Office (GAO), and the Treasury Inspector General for Tax Administration (TIGTA) favorably reviewed the Qualifying Child Study sample design.<sup>7</sup> In its review, Mathematica strongly endorsed the major elements of the study design, in particular, the decision to focus the certification study on a subset of taxpayers with a high likelihood of EITC overclaims (see Appendix B). Mathematica also commended IRS for its use of an array of data sources. GAO reviewed the steps that IRS has taken to implement the certification study and concluded that IRS “has struck a reasonable balance between preventing unreasonable burden on EIC taxpayers and balancing the need to obtain information on whether certification can be a useful approach to improving EIC compliance.” The objective of the TIGTA review was to determine the usefulness of the study in enabling IRS to make decisions regarding the future of the EITC program. TIGTA concluded that the “statistical sampling method used to select the samples for the {study} appears adequate and should provide reliable information on which to base future decisions.”

### *EITC Qualifying Child Residency Certification Process*

In December 2003, the IRS sent the following five documents to the 25,000 taxpayers in the test group:

- ☐ A letter (Notice 84-A) describing the new certification requirement;
- ☐ Form 8836, *Qualifying Children Residency Statement*, which offers three options for certification (to be completed by the taxpayer and returned to IRS). The three options are letters, records, and affidavits;
- ☐ A third party affidavit (*Schedule A* or *Schedule B*) to be filed with Form 8836, attesting to the validity of the taxpayer’s child residency certification on Form 8836;
- ☐ Publication 3211M, *Earned Income Tax Credit Questions and Answers*; and
- ☐ Publication 4134, *Free/Nominal Cost Assistance Available for Low Income Taxpayers*.

The letters, forms, and publications were in English, like the tax packages that IRS mails to all taxpayers each December (see Appendix C for copies of Notice 84-A, Form 8836, and Schedules A and B). The letter, Form 8836, and affidavit refer Spanish-speaking persons to a telephone customer service center from which they can request copies of these documents in Spanish. The Qualifying Child Study marks the first usage of affidavits for IRS tax administration purposes.

Form 8836 requires proof of the qualifying child residency in the form of records, a letter on official letterhead, or a signed affidavit (Schedule A) from any of the following: attorney, child-care provider, clergy, community-based organization, court or placement agency official, employer, health-care provider, Indian tribe official, landlord or property manager, law enforcement officer, school official, or social service agency or other government official. The taxpayer may also provide records from utility companies (e.g., bills) to document that he or she meets the residency requirements.

A subsample of 1,000 taxpayers received an alternate third party affidavit (Schedule B) that broadens the definition of those allowed to certify the taxpayer's residency. The alternate third party affidavit defines those eligible to complete the form more generally as those (except family of the taxpayer) with personal knowledge or records showing that the taxpayer and qualifying child lived together during the tax year. In testing this alternate affidavit, the IRS is responding to concerns that taxpayers may have difficulty obtaining certification through any of the other approved sources and may most easily prove that they meet the qualifying child residency requirement using this form of certification.

In response to concerns that the English-only documents might weaken participation among taxpayers with limited English proficiency, the IRS sent both English and Spanish letters and forms to the randomly selected second subsample of 1,000 taxpayers, as noted earlier. This subsample was selected at random because the IRS lacks the type of information necessary to identify those taxpayers who would most benefit from the Spanish documents: those with low English proficiency who can read Spanish and those who have better access to Spanish-literate than to English-literate persons who might assist them.

For each of these two subsamples, the IRS evaluation will focus on the impact of the alternative procedures on the proportion of taxpayers who return Form 8836. For the first subsample, the IRS will examine the type of third party providing certification documents. A possible impact of the alternate affidavit, and one that concerns the IRS, is to shift taxpayers away from preferred, official sources to more informal and potentially less reliable (or verifiable) sources. The IRS will further explore the validity and reliability of third-party affidavits.



For this reason, the IRS will verify that the third parties listed as certifying residency on the certification forms did indeed provide the requested information and were also in a position to substantiate that the child met residency requirements. IRS will also verify records and letters submitted by taxpayers for child residency certification. Verification will be carried out for a subsample of the 25,000 taxpayers in the test group.

For the Qualifying Child Study, certification occurs at the time of filing. Taxpayers were instructed to submit their certification materials when they filed their tax returns.<sup>8</sup> The goal is to work the cases as quickly as possible and therefore minimize, to the extent possible, delays in payment of the credit to eligible taxpayers.<sup>9</sup>

The process was designed to give taxpayers sufficient time to respond to IRS requests (for example, requests for additional information or notifications of decisions). In cases where taxpayers do not substantiate the residency of a child claimed for EITC, the credit must be disallowed through IRS deficiency procedures. To those taxpayers who do not respond within 30 days to IRS's initial certification decision letter, IRS will send a second letter, not part of IRS standard procedures, that notifies the taxpayer a second time of the decision and requests a response. In general, IRS waits at least 30 days for a response from a taxpayer (90 days for the statutory *Notice of Deficiency*) before moving on to the next step in a process. Thus, the completion of the certification process could reasonably be expected to take several months for taxpayers who do not respond immediately to the IRS.

### *EITC Qualifying Child Residency Certification Study Evaluation Plan*

The IRS is evaluating the certification program to determine if the certification process achieved all of its operational objectives and to assess the impact of the certification process on compliance and participation. The evaluation is already in progress (see Qualifying Child Residency Certification Study, Status and Results for data collection and preliminary evaluation results). During the next few months, IRS expects to complete certification for all cases currently in process. Once this information, as well as data from the survey and third-party verification, is available, IRS will be able to undertake a more comprehensive analysis of the certification process. This analysis will be presented in the final report when it is issued in June 2005.

Major questions to be answered by the full evaluation address both the outcome and the process of certification and include:

- ☐ Did sample members submit certification forms, and did these contain sufficient information to establish whether or not the residency requirement was satisfied?



- ☐ Did sample members continue to claim the EITC with qualifying children but not certify their residency?
- ☐ Did sample members change the number of qualifying children claimed?
- ☐ Did sample members file tax returns but not claim the EITC?
- ☐ Did sample members not even file tax returns?
- ☐ How did Spanish language documents affect these outcomes?
- ☐ How did the alternate third party affidavit affect these outcomes?

The IRS has confirmed that, as expected, the test group and the control group show a high level of agreement in terms of their demographic composition because they were randomly selected from the same population. This will allow IRS to make detailed comparisons between the test group and the control group.

Unstated, but implicit, in these questions and the related data collection are larger questions regarding the impact of certification on compliance and participation with the EITC. For test group taxpayers who no longer claimed qualifying children or did not claim the EITC credit at all, the most important question is why. Possible reasons may include fear of detection, an improved understanding of EITC eligibility rules, changes in the family situation that affect eligibility, or an inability or unwillingness to deal with the certification process. Related to this, IRS also seeks to know the number of taxpayers who attempted to certify but did not complete the process and why.

In April 2004, IRS initiated an effort to design a survey of a subset of taxpayers in the test group. The survey results will provide IRS with insights about claimants' experiences with the certification process and the impact of certification on filing behavior, on EITC participation, and on EITC eligibility. Westat Corporation will conduct the survey on behalf of the IRS. It will be administered primarily by telephone to taxpayers included in the study. Efforts will be made to maximize response rates. Data will be confidential, and taxpayer identities for individual-level survey results will not be shared with the IRS.

The information self-reported in this survey is the primary data used by IRS in determining whether sampled taxpayers were eligible for the EITC and in determining whether eligible taxpayers were deterred from claiming the EITC. It will also be used to probe the details of taxpayers' certification experiences in order to improve the certification process.

The following subsections describe the Qualifying Child Study evaluation plan at a more detailed level.

**Response to Certification Requirement.**--The IRS plans to undertake a substantial amount of analysis to assess how certification affects compliance and participation. At this time, sufficient data are not available to support these analyses. Therefore, this report will focus on the structure of future analyses.

The IRS is tabulating and analyzing information gathered from the certification study. The survey information will be fully analyzed later in the year. When completed, the IRS will report both counts and associated EITC dollars claimed and claims certified. This information will be reported for the entire sample, as well as for the subsamples. IRS plans to evaluate whether the alternative affidavit increases the response to certification or the percentage of taxpayers who successfully certify. The IRS will also look for other differences among the study groups.<sup>10</sup> When completely tabulated and analyzed, the entire data set will allow the IRS to systematically address the following questions:

- ☐ *What was the overall outcome of the certification process, i.e., who certified and who did not?* The study will capture the actual number of returns filed, and the number of those who did and did not claim EITC. It will provide a profile of taxpayers who claimed EITC, e.g., filing mode (electronically-filed versus paper and paid preparer versus self-prepared), filing status, and any changes in filing status from the previous year.
- ☐ *What is the filing profile of taxpayers who responded (or did not respond) to the certification requirement?* For those taxpayers claiming EITC, the study will capture the number of taxpayers who claimed children, and, of those, the number of children claimed. It will also capture the number of claims certified versus those not certified, and, of those not certified, the study will identify whether documentation was provided and why it was not sufficient. It will also identify the number of cases that receive the full, versus partial, amount claimed and the average amount of EITC claimed versus the average amount allowed.
- ☐ *What were the characteristics of the documentation submitted by respondents?* The study will identify the types and volume of documentation used to certify residency, i.e., whether records and/or letters were used, and the type of affidavit that was prepared, if any. It will capture the distribution of the number of certification documents used by claimants. It will also capture the types and amounts of IRS and third-party assistance required to meet the certification requirements.

- ☐ Was the documentation submitted by respondents valid? IRS will review the three possible types of documentation provided by taxpayers, including official records, letters on official letterhead from third parties, and signed affidavits, and it will determine the percentage of those documents that were accepted.

In addition, IRS will provide results related to communication in Spanish, including information on the usage of Spanish language telephone assisters and submission of Spanish language forms. This information will be broken out according to whether or not the taxpayer was in the Spanish form subsample.

#### **Impact of Certification Program on Tax Filing and EITC Participation.--**

The IRS will analyze data from the Qualifying Child Study to determine how the qualifying child certification affects the filing of tax returns. The IRS will examine filing patterns (i.e., non-filing, timing of filing) of both the test and control groups to identify differences between the groups.

Using data from a number of sources, IRS will investigate how the Qualifying Child Study affected the participation of eligible EITC taxpayers and whether, as intended, it deterred participation by ineligible. The IRS will use fact-of-filing information and tax return data for both the test and control groups to identify the impact of certification on claims for the EITC. For example, estimates will include:

- ☐ The total percentage of taxpayers who claim the EITC, with or without children;
- ☐ The percentage of taxpayers who claim the EITC with a qualifying child (combined and by number of qualifying children); and
- ☐ The percentage of taxpayers who claim the EITC without a qualifying child.

By comparing the test group and the control group, IRS will be able to assess the overall effect of certification on EITC claims. IRS will use these particular estimates in conjunction with other information to distinguish the effects of certification on eligible taxpayers and ineligible taxpayers. The survey to be conducted by Westat will allow IRS to learn the reasons why a taxpayer did not claim the EITC.

Based on the information self-reported on the Westat survey, IRS will determine whether the taxpayer appeared eligible for the EITC with a qualifying child. IRS will then analyze the survey results, along with EITC claims and certification outcomes, to determine whether eligible taxpayers have been deterred from participating, and, if so, to what extent. This type of analysis

will also be used to assess whether the program has successfully deterred some ineligible taxpayers from claiming and/or receiving the credit. Because survey data are qualitative and self-reported, these estimates will not be very precise.

In addition, the IRS will analyze internal return transaction data to determine the extent to which the sampled taxpayers claimed the EITC with children other than those submitted for certification. The data will also be analyzed to determine whether the children in the certification sample were no longer claimed by the sampled EITC taxpayers but were instead claimed by other taxpayers for EITC purposes. A comparison between the test and the control groups will be made on this issue.

**Impact of Certification Program on EITC Amounts.--**To determine the effects of the certification requirement on the amount of EITC claimed, IRS will compare the amount of EITC claimed by those in the test group with the amount claimed by those in the control group. IRS will analyze the amount of EITC claimed by those in the test group (for taxpayers who certified and those who failed to certify) and the amount allowed by those in the test group after the certification process. IRS will use survey data from Westat to help in developing estimates of protected revenue and the amounts of EITC not claimed by taxpayers who appear eligible.

**Impact of Certification Program on Burden to Participants and IRS.--**The analysis of taxpayer burden will estimate both time spent on complying with the residency certification requirements and out-of-pocket costs. The time estimates will include the amount of time spent communicating with the IRS, preparers, third parties who provide the certifying documents, and any other parties, including family members. Time estimates also include the time spent obtaining documents or any other materials and records needed in support of the certification requirement. Out-of-pocket expenses include preparer or documentation fees and any other related costs incurred by the taxpayer in order to comply with the residency certification requirement.

IRS administrative cost estimates cover such items as time spent processing and reviewing the certification documents, followup with taxpayers where necessary, additional infrastructure costs, and any marginal changes in enforcement time. The goal of these cost and burden analyses is to determine if certification is a cost-effective way to reduce erroneous EITC payments while maintaining historically high participation rates.

**Respondent Attitudes about Certification Process.--**The Westat survey will ask questions about study taxpayers' experiences in and attitudes on the certification process. Some of the key questions that IRS wants to answer include:

- ☐ How did claimants perceive the process? What additional burden did the certification process impose in terms of time and out-of-pocket expenses?
- ☐ Did the certification process frustrate or deter them from claiming EITC or the qualifying children?

### *Qualifying Child Residency Certification Study, Status and Results*

IRS is now collecting and analyzing certification data (Forms 8836 and the Schedules A and B) from taxpayers included in the sample of the Qualifying Child Study and, at the same time, finalizing the telephone/mail survey instrument for a subsample of the taxpayers included in the study.

At this point, only preliminary information is available from the study. As previously noted, completion of the certification process may require several months because of the nature of IRS deficiency procedures, including expected taxpayer delays in responding to IRS. The IRS expects that the responses received so far may include a bias toward taxpayers who were eligible for the EITC and were more easily able to comply with the certification requirement. The impact on those who had more difficulty with the certification process or with the tax return preparation process, in general, or those who may not claim the EITC or even file a tax return has not been analyzed or surveyed at this time. Therefore, caution should be used in interpreting these preliminary results.

Final analyses of the study and survey results will be included in the final report that the IRS will send to Congress in the summer of 2005. The study data included in this report are preliminary, but provide a snapshot of the type of data that will be available at the close of the study. Further analysis of the data, including correlations between various data elements and taxpayer attributes, will also be in the final report.

Table 2 presents the disposition of the original study group for the Qualifying Child Study. IRS selected 25,000 taxpayers for inclusion in the study based on returns filed for Tax Year 2002. The adjusted test group final sample of 24,711 includes 121 taxpayers who filed as married filing jointly in Tax Year 2002 but did not file joint returns in Tax Year 2003. IRS excluded about 2 percent of the original sample because these taxpayers resided in a disaster area, were in combat, or had their returns already under examination by IRS.

Table 3 presents the status of returns in the study groups. As of the end of June 2004, some 21,409 test group returns have been filed, or about 87 percent of the total test group. This compares with 22,215 control group returns that have been filed, or 88 percent. About two-thirds, or 16,362 of the returns in the total test group, claimed EITC with qualifying children. This compares with 18,431 in the control group, or 73 percent of returns in the control group.

Table 2. EITC Qualifying Child Residency Certification Study: Number of Returns

	Schedule A	Schedule B	Schedule A-Spanish	Total Test	Control
<b>Original Sample</b>	<b>23,000</b>	<b>1,000</b>	<b>1,000</b>	<b>25,000</b>	<b>25,000</b>
Added--Married Filing Jointly Return Split	111	5	5	121	127
Adjusted Sample	23,111	1,005	1,005	25,121	25,127
Excluded*	<u>370</u>	<u>16</u>	<u>24</u>	<u>410</u>	<u>N.A.</u>
<b>Final Sample</b>	<b>22,741</b>	<b>989</b>	<b>981</b>	<b>24,711</b>	<b>25,127</b>

\*The majority (313) of these were excluded prior to the initial mailing. Most were excluded because the taxpayer's address was in the California wildfire disaster area.

Table 3. EITC Qualifying Child Residency Certification Study: Tax Year 2003 Return Status

	Schedule A	Schedule B	Schedule A-Spanish	Test Group	Control Group
<b>I. Number of Returns</b>					
<b>Filed Tax Return for TY 2003</b>	<b>19,714</b>	<b>872</b>	<b>823</b>	<b>21,409</b>	<b>22,215</b>
Claimed EITC with Children	15,064	678	620	16,362	18,431
<i>Claimed one child</i>	7,624	352	316	8,292	8,869
<i>Claimed two children</i>	7,440	326	304	8,070	9,562
Claimed EITC without Children	634	25	22	681	464
Did not Claim EITC	4,016	169	181	4,366	3,320
<b>Did Not Yet File Tax Return for TY 2003</b>	<b><u>3,027</u></b>	<b><u>117</u></b>	<b><u>158</u></b>	<b><u>3,302</u></b>	<b><u>2,912</u></b>
<b>Total</b>	<b>22,741</b>	<b>989</b>	<b>981</b>	<b>24,711</b>	<b>25,127</b>
In Process	6,883	405	287	7,575	N.A.
Processing Complete	<u>8,181</u>	<u>273</u>	<u>333</u>	<u>8,787</u>	<u>N.A.</u>
<b>Total</b>	<b>15,064</b>	<b>678</b>	<b>620</b>	<b>16,362</b>	<b>N.A.</b>
<b>II. Number of Returns as Percent of Total</b>					
<b>Filed Tax Return for TY 2003</b>	<b>87%</b>	<b>88%</b>	<b>84%</b>	<b>87%</b>	<b>88%</b>
Claimed EITC with Children	66%	69%	63%	66%	73%
<i>Claimed one child</i>	34%	36%	32%	34%	35%
<i>Claimed two children</i>	33%	33%	31%	33%	38%
Claimed EITC without Children	3%	3%	2%	3%	2%
Did not Claim EITC	18%	17%	18%	18%	13%
<b>Did Not Yet File Tax Return for TY 2003</b>	<b><u>13%</u></b>	<b><u>12%</u></b>	<b><u>16%</u></b>	<b><u>13%</u></b>	<b><u>12%</u></b>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
In Process	46%	60%	46%	46%	N.A.
Processing Complete	<u>54%</u>	<u>40%</u>	<u>54%</u>	<u>54%</u>	<u>N.A.</u>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>N.A.</b>

Note: Detail may not add to Total due to rounding.

Of the total number in the test group claiming EITC with children, about half, 8,292, claimed one child, and half, 8,070, claimed two children. There is a significant difference between the test group and the control group in the percentages of each group that claimed two qualifying children. In the test group, only 33 percent claimed two qualifying children, while 38 percent of the control group claimed two qualifying children.

IRS has completed processing for 8,787 returns of the total of 16,362 taxpayers in the test group who filed for Tax Year 2003 and claimed EITC with qualifying children. This represents about 54 percent of taxpayers in the test group who filed with qualifying children. IRS is currently still processing 7,575 test group returns, or about 46 percent of those returns. IRS plans to explore these preliminary results further to determine their implications for EITC compliance and participation.

Table 4 presents information on the mode of filing and the use of paid preparers. Of those taxpayers who filed EITC claims with qualifying children, more than 80 percent of returns were filed electronically in both the test

**Table 4. EITC Qualifying Child Residency Certification Study: Electronic Filing and Use of Paid Preparer for Tax Year 2003 Filers**

	Test Group		Control Group	
	All Filers	Filers Claiming EITC with Qualifying Child	All Filers	Filers Claiming EITC with Qualifying Child
<b>I. Number of Returns</b>				
<b>Filed Electronically</b>	<b>16,610</b>	<b>13,319</b>	<b>17,998</b>	<b>15,479</b>
<i>Paid Prepared</i>	<i>14,183</i>	<i>11,557</i>	<i>15,291</i>	<i>13,261</i>
<i>Self-Prepared</i>	<i>2,427</i>	<i>1,762</i>	<i>2,707</i>	<i>2,218</i>
<b>Filed on Paper</b>	<b>4,799</b>	<b>3,043</b>	<b>4,217</b>	<b>2,952</b>
<i>Paid Prepared</i>	<i>2,319</i>	<i>1,553</i>	<i>2,048</i>	<i>1,428</i>
<i>Self-Prepared</i>	<i>2,480</i>	<i>1,490</i>	<i>2,169</i>	<i>1,524</i>
<b>Total</b>	<b>21,409</b>	<b>16,362</b>	<b>22,215</b>	<b>18,431</b>
<b>II. Number of Returns as Percent of Total</b>				
<b>Filed Electronically</b>	<b>78%</b>	<b>81%</b>	<b>81%</b>	<b>84%</b>
<i>Paid Prepared</i>	<i>66%</i>	<i>71%</i>	<i>69%</i>	<i>72%</i>
<i>Self-Prepared</i>	<i>11%</i>	<i>11%</i>	<i>12%</i>	<i>12%</i>
<b>Filed on Paper</b>	<b>22%</b>	<b>19%</b>	<b>19%</b>	<b>16%</b>
<i>Paid Prepared</i>	<i>11%</i>	<i>9%</i>	<i>9%</i>	<i>8%</i>
<i>Self-Prepared</i>	<i>12%</i>	<i>9%</i>	<i>10%</i>	<i>8%</i>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

*Note: Detail may not add to Total due to rounding.*



and control groups. About 81 percent of the test group and 84 percent of the control group filed electronically. Most taxpayers used paid preparers, again, whether they were included in the test or control group. In fact, 80 percent of taxpayers who filed with qualifying children, in both the test group and the control group, used a paid preparer. The IRS plans to further explore the above results.

Tables 5a and 5b present information on the filing status of taxpayers who have filed returns for Tax Year 2003 and are in the test and control groups. The table shows that, for the test group, 83 percent (13,540) of those who claimed the EITC with one or more qualifying children filed as head of household. For both the test and control groups, the percentage of taxpayers who filed as married filing jointly and claimed the EITC with qualifying children (9 percent and 8 percent, respectively) was greater than the percentage for the same group in the Tax Year 2002 study population (5 percent). IRS will examine these results further as the certification process progresses.

**Table 5a. EITC Qualifying Child Residency Certification Study:  
Number of Returns by Filing Status for Tax Year 2003**

	Test Group		Control Group	
	All Filers	Filers Claiming EITC with Qualifying Child	All Filers	Filers Claiming EITC with Qualifying Child
Single	3,759	1,296	2,923	1,415
Married Filing Jointly	2,330	1,526	2,192	1,497
Married Filing	101	0	81	0
Head of Household	<u>15,219</u>	<u>13,540</u>	<u>17,019</u>	<u>15,519</u>
<b>Total</b>	<b>21,409</b>	<b>16,362</b>	<b>22,215</b>	<b>18,431</b>

**Table 5b. EITC Qualifying Child Residency Certification Study: Percentage of Returns by Filing Status for Tax Years 2003 & 2003**

	Test Group: TY 2003		Control Group: TY 2003		Study Population: TY 2002
	All Filers	Filers Claiming EITC with a Qualifying Child	All Filers	Filers Claiming EITC with a Qualifying Child	
Single	18%	8%	13%	8%	9%
Married Filing Jointly	11%	9%	10%	8%	5%
Married Filing Separately	0%	0%	0%	0%	0%
Head of Household	<u>71%</u>	<u>83%</u>	<u>77%</u>	<u>84%</u>	<u>85%</u>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

*Note: Detail may not add to Total due to rounding.*

Table 6 presents the filing status distribution for Tax Years 2002 and 2003. The filing status distribution appears to have changed between Tax Year 2002 and Tax Year 2003 for both the test and control groups. For those taxpayers who filed for Tax Year 2003 and are included in the test group, 12 percent filed as head of household for Tax Year 2002 and filed as single for Tax Year 2003. For those filers included in the control group, however, only about 8 percent changed filing status from head of household to single.

About 78 percent of all filers in the test group (including those not claiming the EITC) and 83 percent of all filers in the control group maintained the same filing status from the previous year (Table 6.I). About 88 percent of those taxpayers who claimed the EITC with qualifying children maintained the same filing status from the previous year for both the test group and the control group (Table 6.II). IRS will explore these results further.

**Table 6. EITC Qualifying Child Residency Certification Study: Filing Status Distribution for Tax Years 2002 and 2003**

<b>I. All Filers</b>								
<b>Tax Year 2002 Filing Status</b>	<b>Test Group</b>				<b>Control Group</b>			
	<b>Tax Year 2003 Filing Status</b>				<b>Tax Year 2003 Filing Status</b>			
	<b>Single</b>	<b>Married Filing Jointly</b>	<b>Head of Household</b>	<b>Total</b>	<b>Single</b>	<b>Married Filing Jointly</b>	<b>Head of Household</b>	<b>Total</b>
Single	5%	1%	3%	9%	5%	0%	3%	9%
Married Filing Jointly	0%	5%	0%	5%	0%	5%	1%	5%
Head of Household	<u>12%</u>	<u>5%</u>	<u>68%</u>	<u>85%</u>	<u>8%</u>	<u>5%</u>	<u>73%</u>	<u>85%</u>
<b>Total</b>	<b>18%</b>	<b>11%</b>	<b>71%</b>	<b>100%</b>	<b>13%</b>	<b>10%</b>	<b>77%</b>	<b>100%</b>

  

<b>II. Filers Claiming EITC with Qualifying Child</b>								
<b>Tax Year 2002 Filing Status</b>	<b>Test Group</b>				<b>Control Group</b>			
	<b>Tax Year 2003 Filing Status</b>				<b>Tax Year 2003 Filing Status</b>			
	<b>Single</b>	<b>Married Filing Jointly</b>	<b>Head of Household</b>	<b>Total</b>	<b>Single</b>	<b>Married Filing Jointly</b>	<b>Head of Household</b>	<b>Total</b>
Single	4%	0%	3%	8%	4%	0%	4%	9%
Married Filing Jointly	0%	5%	1%	5%	0%	4%	1%	5%
Head of Household	<u>3%</u>	<u>4%</u>	<u>79%</u>	<u>86%</u>	<u>3%</u>	<u>3%</u>	<u>80%</u>	<u>86%</u>
<b>Total</b>	<b>8%</b>	<b>9%</b>	<b>83%</b>	<b>100%</b>	<b>8%</b>	<b>8%</b>	<b>84%</b>	<b>100%</b>

*Note: Detail may not add to Total due to rounding.*

Table 7a presents the distribution of documents by type of document sent to the IRS. The table shows that 57 percent of documents submitted by taxpayers in the test group were official letters and records, while the remain-

ing documents were affidavits from third parties. Table 7b presents the distribution of documents by number of documents submitted per taxpayer and the number of telephone calls made to IRS per taxpayer. The majority of taxpayers, 65 percent, submitted one or two documents, while 14 percent submitted five or more.

As a part of the Qualifying Child Study, IRS captures data on the number of calls received from taxpayers. While IRS captures information on the number of telephone calls, only about half can be associated with the taxpayers who made the calls because taxpayers do not have to identify themselves to ask general questions about processes. For those taxpayers whose calls could be associated to them, about 53 percent made one or two calls, while only about 7 percent made 11 or more calls.

**Table 7a. EITC Qualifying Child Residency Certification Study: Distribution of Documents Submitted by Type of Document**

Document Type	Document Type as Percent of Total			
	Schedule A	Schedule B	Schedule A-- Spanish	Test Group
Records	39%	39%	36%	38%
Statement/Letter	19%	19%	21%	19%
Affidavit	<u>42%</u>	<u>42%</u>	<u>43%</u>	<u>42%</u>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

**Table 7b. EITC Qualifying Child Residency Certification Study:  
Distributions of Number of Documents Submitted to IRS per Taxpayer and  
Number of Telephone Calls Made to IRS per Taxpayer**

Number Per Taxpayer	Percent of Taxpayers			
	Schedule A	Schedule B	Schedule A-- Spanish	Test Group
<b>I. Documents Submitted</b>				
1-2	65%	62%	66%	65%
3-4	22%	22%	18%	22%
5 or more	<u>13%</u>	<u>16%</u>	<u>16%</u>	<u>14%</u>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>II. Telephone Calls</b>				
1-2	53%	49%	53%	53%
3-4	21%	23%	23%	21%
5-10	20%	19%	17%	20%
11 or more	<u>7%</u>	<u>10%</u>	<u>7%</u>	<u>7%</u>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

*Note: Detail may not add to Total due to rounding.*

## EITC Filing Status Study

The Tax Year 1999 EITC compliance study identified filing status errors as a major contributor to EITC overclaims. Many EITC claimants improperly filed as single or head of household when they should have filed as either married filing jointly or married filing separately. Using the proper filing status would have substantially reduced the amount of EITC received or made those taxpayers ineligible for the credit altogether.

The Filing Status Study, like the Qualifying Child Study, examines a sample of EITC claimants who may have a high likelihood of filing returns with EITC overclaims. These are taxpayers who previously filed as married (either jointly or separately) and now file as single or head of household. The Filing Status Study will investigate the impact of requiring EITC taxpayers to document their marital statuses. The study is also designed to test whether a third-party locator service is helpful in identifying taxpayers who may be married and living together but not using the proper filing status.

Taxpayers randomly selected for inclusion in the Filing Status Study were not contacted prior to filing their Tax Year 2003 returns (accordingly, there is no need for a control group to compare filing behavior). When they file these returns, the EITC portions of their refunds are frozen, and they are asked to provide additional information about their marital statuses if they claimed EITC and if they filed as single or head of household. The information requested includes the basis for their filing statuses, such as a divorce decree, legal separation papers, or other documentation. IRS examiners use the information furnished by claimants as the sole basis for determining whether the marital status is consistent with the filing status.

### *EITC Filing Status Study Sample Development*

In determining the sample frame for the Filing Status Study, the IRS removed the Qualifying Child Study sample frame of 400,000 returns from the 1.6 million returns that comprised the 10-percent random sample of the eligible EITC population. Taxpayers who filed as married filing jointly in Tax Year 2002 were also removed, as were single or head of household returns where the taxpayer had not filed as married filing separately or married filing jointly at least once in the prior 3 years. The same exclusions were applied to the Filing Status Study sample as were applied to the Qualifying Child Study sample. For example, returns for taxpayers already subject to other treatments, such as examination, and returns for taxpayers located in combat or disaster zones were removed from the sample frame. The sample frame for the Filing Status Study consists of taxpayers filing as single or head of household. From the sample frame (roughly 69,000 taxpayers), a sample of 36,000 was drawn.

### *EITC Filing Status Study Evaluation Plan*

IRS will collect data to support the two separate, but interrelated, analyses, each with the goal of reducing EITC overclaims by improving the accuracy of filing status reporting. These are:

- ☐ Test the feasibility of using a residential locator service as a reliable means of identifying filing status discrepancies; and
- ☐ Perform data mining to identify potential indicators of EITC errors and modes of noncompliance, based on the entire data sample and related IRS information sources.

The data collected in the course of the Filing Status Study will directly answer a number of questions. These include the following:

- ☐ What are the characteristics and filing histories of both the respondents and nonrespondents?
- ☐ How many taxpayers in the sample were able to successfully verify their filing statuses, and how many did not?
- ☐ For those who did not, how many responded, and how many responded with documentation not accepted by the IRS?

### *EITC Filing Status Study, Status, and Results*

The results for the Filing Status Study are preliminary at this point. As with the Qualifying Child Study, the information reported in these tables may change after all of the returns are processed. Therefore, caution should be exercised in considering the preliminary results.

Table 8 presents the disposition of the sample for the Filing Status Study. IRS selected a sample of 36,000 taxpayer returns to be included in the Filing Status Study. The selected taxpayers filed as single or head of household in Tax Year 2002 but had filed as married filing jointly or separately in at least 1 of the 3 previous years. As part of the Filing Status Study, IRS required those 26,803 taxpayers who filed as single or head of household and claimed EITC in Tax Year 2003 to document their marital statuses. There were 3,321 taxpayers who filed as single or head of household and did not claim EITC, and 3,506 taxpayers who filed as married for Tax Year 2003; IRS did not require these two taxpayer groups to document their marital statuses. IRS excluded 71 returns because taxpayers were in combat or their returns were selected for examination on other issues. No returns were excluded because taxpayers resided in disaster zones. As of the end of June 2004, some 94 percent of the

sample of taxpayers have filed returns. IRS has completed processing for 18,520 returns, or 69 percent of those who claimed EITC, and is currently processing 8,283 returns, or about 31 percent.

Following processing and review of the filing status documentation for these claims, IRS plans to compare the results to residential locator service information to assess its reliability for potential use in identifying filing status discrepancies.

**Table 8. EITC Filing Status Study: Tax Year 2003 Return Status**

	<b>Number of Returns</b>	<b>Percent of Total</b>
<b>Filed Tax Return for TY 2003</b>	<b>33,701</b>	<b>94%</b>
Single or Head of Household Filing Status and claimed EITC	26,803	74%
Single or Head of Household Filing Status and did not claim EITC	3,321	9%
Married Filing Status	3,506	10%
Excluded--Other (combat, audit)	71	0%
<b>Did Not Yet File Tax Return for TY 2003</b>	<b><u>2,299</u></b>	<b><u>6%</u></b>
<b>Total</b>	<b>36,000</b>	<b>100%</b>
In Process	8,283	31%
Processing Complete	<u>18,520</u>	<u>69%</u>
<b>Total</b>	<b>26,803</b>	<b>100%</b>

Table 9a presents electronic filing and paid preparer data for all taxpayers in the Filing Status study sample who filed for Tax Year 2003 and the subset of those who filed as single or head of household and claimed the EITC. For those taxpayers who filed as single or head of household and filed EITC claims, 77 percent of returns were filed electronically, and 70 percent used paid preparers. Table 9b presents filing status data for all taxpayers in the study who filed in Tax Year 2003 and the subset of those who filed as single or head of household and claimed the EITC. Of those who filed as single or head of household and claimed the EITC, 93 percent filed as head of household.

Table 10a depicts the distribution of documents by type of document, and Table 10b indicates the distribution of documents by number of documents submitted and the number of telephone calls made to IRS per taxpayer. These tables indicate that 79 percent of the documents submitted by taxpayers in the filing status sample to support their filing statuses were records. The majority of taxpayers, 83 percent, submitted one or two documents, while only 7 percent submitted five or more. As a part of the Filing Status

**Table 9a. EITC Filing Status Study: Electronic Filing and Use of Paid Preparer For Tax Year 2003 Filers**

	Number of Returns		Percent of Total	
	All Filers	Single / Head of Household Filers Claiming EITC	All Filers	Single / Head of Household Filers Claiming EITC
<b>Filed Electronically</b>	<b>24,978</b>	<b>20,526</b>	<b>74%</b>	<b>77%</b>
<i>Paid Prepared</i>	<i>18,791</i>	<i>15,514</i>	<i>56%</i>	<i>58%</i>
<i>Self-Prepared</i>	<i>6,187</i>	<i>5,012</i>	<i>18%</i>	<i>19%</i>
<b>Filed on Paper</b>	<b>8,723</b>	<b>6,277</b>	<b>26%</b>	<b>23%</b>
<i>Paid Prepared</i>	<i>4,541</i>	<i>3,286</i>	<i>13%</i>	<i>12%</i>
<i>Self-Prepared</i>	<i>4,182</i>	<i>2,991</i>	<i>12%</i>	<i>11%</i>
<b>Total</b>	<b>33,701</b>	<b>26,803</b>	<b>100%</b>	<b>100%</b>

**Table 9b. EITC Filing Status Study: Filing Status For Tax Year 2003 Filers**

	Number of Returns		Percent of Total	
	All Filers	Single / Head of Household Filers Claiming EITC	All Filers	Single / Head of Household Filers Claiming EITC
<b>Single</b>	2,641	1,873	8%	7%
<b>Head of Household</b>	27,554	24,930	82%	93%
<b>Married</b>	<u>3,506</u>	<u>N.A.</u>	<u>10%</u>	<u>N.A.</u>
<b>Total</b>	<b>33,701</b>	<b>26,803</b>	<b>100%</b>	<b>100%</b>

*Note: Detail may not add to Total due to rounding.*

Study, IRS captures data on the total number of calls received from taxpayers. While IRS captures information on the number of calls, about 80 percent can be associated with the taxpayers who made the calls. Taxpayers do not need to identify themselves if they are asking general questions. For those taxpayers with telephone calls associated to them, about 65 percent made one or two calls, while only about 2 percent made 11 or more calls.

## EITC Automated Underreporter Study

Income misreporting is among the three most common errors made by taxpayers in claiming the EITC. The Automated Underreporter (AUR) Study is an IRS initiative to focus compliance efforts on taxpayers who claim EITC but are either ineligible because their incomes are too high or eligible but overclaim the EITC because of misreported income. The IRS receives informa-



**Table 10a. EITC Filing Status Study: Distribution of Documents Submitted by Type of Document**

<b>Document Type</b>	<b>Document Type as Percent of Total</b>
Records	79%
Statement/Letter	21%
<b>Total</b>	<b>100%</b>

**Table 10b. EITC Filing Status Study: Distributions of Number of Documents Submitted to IRS per Taxpayer and Number of Telephone Calls Made to IRS per Taxpayer**

<b>Number Per Taxpayer</b>	<b>Percent of Taxpayers</b>
<b>I. Documents Submitted</b>	
1-2	83%
3-4	10%
5 or more	7%
<b>Total</b>	<b>100%</b>
<b>II. Telephone Calls</b>	
1-2	65%
3-4	21%
5-10	12%
11 or more	2%
<b>Total</b>	<b>100%</b>

tion returns from third-party payers who report certain taxpayer income (e.g., wages on a Form W-2 or nonemployee compensation on a Form 1099). However, because it takes several months to process and compile, this third-party information is unavailable for matching with tax returns until September and, therefore, cannot be used for income verification when a taxpayer's return is filed and the EITC is paid during the filing season. This limits the ability of the IRS to identify misreported income at the time a return is filed and prevent EITC overclaims during processing. AUR cases are generally selected based only on overall potential tax change (excluding changes in tax credits). The AUR program does not currently identify the impact of identified changes in total income on EITC eligibility and the resulting allowable credit.

Beginning in 2003, the IRS initiated a study that uses tax returns filed in Tax Year 2002 to identify, through document matching, EITC claimants with a high likelihood of income reporting errors. The study has two objectives:

- ☐ To observe the impact of applying EITC income criteria to AUR-selected cases in order to determine the overall impact on EITC claims; and
- ☐ To use the resulting EITC data to update the AUR case selection method so that it identifies EITC claimants with a higher likelihood of income reporting errors.

### *EITC Automated Underreporter Study Design*

The IRS selected 300,000 taxpayers who claimed the EITC and for whom there were indications of income misreporting for Tax Year 2002.<sup>11</sup> These taxpayers were selected from a population of approximately 1.2 million cases in the Tax Year 2002 AUR inventory.<sup>12</sup> These EITC cases were drawn from AUR inventory based on AUR processing site, the taxpayer's filing status, the number of children claimed, the EITC claim amount, and the taxpayer's previous AUR case history. In this study, IRS is not freezing refunds or EITC claims.

### *EITC Automated Underreporter Study, Status and Results*

The IRS is in the process of working the 300,000 EITC returns selected for the AUR Study (Table 11). Although the identification of inventory and the initial selection of workload are automated, a tax examiner manually reviews each case. This manual review, referred to as "screening," sometimes results in a case being closed ("screened-out") in AUR at this stage. As of June 2004, all 100 percent (300,000) of selected returns had been screened. Notices were sent to 261,169 taxpayers. Through June, AUR has closed 141,376 of these EITC cases:

- ☐ During the screening phase, 38,831 cases were screened out; and
- ☐ During the response phase, 35,564 were closed without change to the taxpayer's return or EITC claimed amount, and another 66,981 cases were closed with agreement.

The remainder of the cases are awaiting additional taxpayer documents in order to complete the response phase.

The AUR study is due to be completed by the end of September 2004, at which time the results of the analysis will be available. EITC cases have a much lower screen-out rate (13 percent versus 30 percent for other AUR cases). IRS plans to explore these preliminary results further after all the cases are closed, and IRS will determine their implications for EITC compliance and participation.

**Table 11. Automated Underreporter Study: Case Status as of June 2004**

<b>Case Status</b>	<b>Number of Cases</b>
<b>Total Number of Cases in AUR EITC Test</b>	<b>300,000</b>
Number of Cases Screened	300,000
<i>Number of Cases Screened Out</i>	<i>38,831</i>
<i>Number of Notices Sent</i>	<i>261,169</i>
Total Number of Cases Closed	102,545
<i>Number of Cases Closed With No Change</i>	<i>35,564</i>
<i>Number of Cases Closed With Taxpayer Agreement</i>	<i>66,981</i>

The AUR Study was also designed to distinguish between those taxpayers with an established history of repeat underreported income and those with a less established history of underreporting. Depending on the final results of the AUR Study, EITC claimants with an established history of repeat underreported income may, in the future, be subject to a freeze of the EITC portion of their current year claims until they can resolve differences between their reported incomes and IRS records from third-party payers such as employers.

## Footnotes

\*This paper is a reprint (excluding the Executive Summary) of IRS's August 2004 preliminary report to Congress on the FY 2004 EITC initiatives. In their 2004 IRS Research Conference presentation, *Certifying Residency for EITC Qualifying Children: Overview of the FY 2004 Pilot Program*, Karen Masken and Mary-Helen Risler provided a summary of the development and design of these initiatives. The IRS report to Congress was prepared under the direction of Mark J. Mazur, Director, Research, Analysis and Statistics; Mark J. Gillen, Director, Office of Program Evaluation and Risk Assessment; and David R. Williams, Director, EITC. The primary authors of the report were Martha Britton Eller, Karen C. Masken, Daniel J. Opitz, and Mary-Helen Risler.

- <sup>1</sup> Throughout the remainder of the document, these studies will be referred to as the Qualifying Child Study, the Filing Status Study, and the AUR Study, respectively.
- <sup>2</sup> PL 108-199 requires that the IRS Commissioner submit a final report to Congress no later than June 30, 2005, detailing the findings of the Qualifying Child Study.
- <sup>3</sup> The 1999 study also identified another major source of error. This error involved taxpayers claiming EITC using a qualifying child who was also the qualifying child of someone else with a higher modified adjusted

gross income. This EITC eligibility rule was known as the AGI-tiebreaker rule. However, the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA) simplified the tiebreaker rule by replacing, in most cases, an adjusted gross income comparison rule with a relationship-based hierarchy for determining the party eligible to claim the credit in situations where a child is the qualifying child of more than one person. The new rule applies only if a child is claimed (and may be claimed) by more than one person. This law change, first effective for TY 2002 returns, was expected to eliminate the tiebreaker rule as a significant source of EITC error. Consequently, efforts to reduce EITC overclaims were not focused on this source of error.

- <sup>4</sup> IRS research has shown that the major source of error associated with qualifying children involves the residency test rather than the age or relationship tests. Errors occur because taxpayers claim qualifying children who did not live with them for more than half of the year—an EITC requirement.
- <sup>5</sup> The evaluation of the Study is being conducted by the IRS Office of Research, Analysis, and Statistics in conjunction with the Wage and Investment Division Research Office.
- <sup>6</sup> The size of the test group, among other things, reflects IRS's estimate of its capacity to process certification documents and collect data from the sample at the Kansas City Compliance Campus where the data collection for the study is based. One element of the study is to determine the resources required by IRS to handle the certification procedures.
- <sup>7</sup> In the fall of 2003, Mathematica Research Policy, Inc., and GAO finalized their reports, *A Review of the Earned Income Tax Credit Residency Certification Pilot Study* and *Qualifying Child Certification Test Appears Justified, But Evaluation Plan is Incomplete*, respectively. In May 2004, TIGTA finalized its report, *The Statistical Sampling Method Used in the Earned Income Tax Credit Proof of Concept Test Appears Valid*.
- <sup>8</sup> Paper return filers were instructed to attach Form 8836 and supporting documentation (records, letters, and/or affidavits) to their returns and send the returns to Field Compliance Services, Kansas City Campus. Electronic filers were instructed to file their returns as they normally would and then send Form 8836 and supporting documentation to Field Compliance Services, Kansas City Campus.
- <sup>9</sup> Taxpayers who successfully certified prior to the filing season received their EITC without delay when they filed their returns.

- <sup>10</sup> In the review conducted in November 2003, Mathematica Policy Research, Inc., concluded that the IRS Spanish subsample will reliably detect only large differences between it and the other test groups.
- <sup>11</sup> Under normal AUR processing criteria, IRS would have selected approximately the same number of cases that contained an EITC claim.
- <sup>12</sup> The AUR study differs from the Qualifying Child and Filing Status studies in that the taxpayer returns are selected from a different tax year (2002 for AUR and 2003 for the others).

## Appendix A

### Congressional Requirement to Report EITC Study Findings

Public Law 108-199, Section 206 mandated that the IRS conduct a study as part of any program that required taxpayers to certify their eligibility in order to claim the Earned Income Tax Credit. The study would identify the costs, in time and money, to study participants, as well as the administrative costs incurred by IRS in operating the program. In addition, the Congressional language required that the study identify:

- (1) The percentage of individuals included in the program who were not certified for the credit, including the percentage of individuals who were not certified due to—
  - (A) Ineligibility for the credit; and
  - (B) Failure to complete the requirements for certification.
- (2) The percentage of individuals to whom paragraph (1)(B) applies who were—
  - (A) Otherwise eligible for the credit; and
  - (B) Otherwise ineligible for the credit.
- (3) The percentage of individuals to whom paragraph (1)(B) applies who—
  - (A) Did not respond to the request for certification; and
  - (B) Responded to such request but otherwise failed to complete the requirements for certification.
- (4) The reasons—
  - (A) For which individuals described in paragraph (3)(A) did not respond to requests for certification; and
  - (B) For which individuals described in paragraph (3)(B) had difficulty in

completing the requirements for certification.

(5) The characteristics of those individuals who were denied the credit due to—

- (A) Failure to complete the requirements for certification; and
- (B) Ineligibility for the credit.

(6) The impact of the program on non-English speaking participants.

(7) The impact of the program on homeless and other highly transient individuals.

## **Appendix B**

### **Mathematica Policy Research, Inc.**

#### **“A Review of the Earned Income Tax Credit Residency Certification Pilot Study”**

**November 28, 2003**

### **Executive Summary**

The Federal Earned Income Tax Credit (EITC) provides a refundable tax credit equal to a substantial percentage of wages, up to a ceiling that varies by filing status and the number of “qualifying children.” With 19 million taxpayers receiving credits totaling \$32 billion in 2002, the EITC has become an important income support program for millions of low-income workers and their families. Because it is administered through the Federal tax system, which generally does not require beneficiaries to establish their eligibility in order to claim the credit, the EITC has exceedingly low administrative expenses relative to the benefits that it pays; but this carries a steep price. The most recent IRS study of EITC compliance concluded that between \$8.5 and \$9.9 billion of the claims filed in 2000 should not have been paid. Qualifying child errors accounted for the largest share of overclaim dollars (25 percent). The chief compliance issue associated with qualifying children involves the residency test.

On June 14, 2003, the IRS announced a five-point EITC reform initiative. Point five, which is the subject of this report, involves pilot-testing a certification program whereby certain “higher risk” taxpayers would have to establish prior to receiving payment that their qualifying children met the EITC